BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
PETER N. AND ADELE, SHUPP)

Appearances:

For Appellants: George P. Coulter, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel

O P I N I O N

This appeal is made pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Peter N. and Adele Shupp against proposed assessments of additional personal income tax in the amounts of $2,082.09 and $3,115.13 assessed against Peter N. Shupp individually for the years 1951 and 1952, respectively; in the amount of $191.36 assessed against Adele Shupp individually for the year 1952; and in the amounts of $6,215.30 and $8,098.56 assessed against Peter N. and Adele Shupp jointly for the years 1953 and 1954, respectively.

During the years on appeal, Appellant Peter N. Shupp owned and operated a coin machine business as a sole proprietorship. He had pinball games, shuffleboards and late in 1954, the last year under review, he acquired some music equipment. Shupp had both the flipper and the multiple-odd bingo type pinball machines. A former employee estimated that Shupp had about 40 multiple-odd type machines. The records of the City of South Gate indicate that in the fiscal year 1950-1951 Appellant had 18 pinball games located in 11 various cafes, liquor stores, etc. These figures increased each year until 1954-1955 when he had 28 pinball machines in 17 locations in the City of South Gate. The proceeds of each machine, after exclusion of expenses claimed by the location owner in connection with the operation of the machine, were divided equally between Shupp and the location owner.

The gross income reported in Appellants' tax returns was the total of the net amounts Shupp retained from locations. Deductions were taken for depreciation and other business expenses.

Respondent determined that Shupp was renting space in the locations where his machines were placed and that all the

coins deposited in the machines constituted gross income to him. Respondent also disallowed all expenses pursuant to Section 17359 (now 17297) of the Revenue and Taxation Code which read:

> In computing net income, no deductions shall be allowed to any taxpayer on any of his gross income derived from illegal activities as defined in Chapters 9, 10 or 10.5 of Title 9 of Part 1 of the Penal Code of California; nor shall any deductions be allowed to any taxpayer on any of his gross income derived from any other activities which tend to promote or to further, or are connected or associated with, such illegal activities.

Appellant Peter N. Shupp was called as a witness and was asked questions about the operation of his coin machine business. Aside from stating that he did not acquire any music equipment until late 1954, Shupp refused to answer any questions on the ground of possible self-incrimination. From such refusal, we infer that if the questions had been answered truthfully, the answers would have supported the Franchise Tax Board's factual contentions. (Fross v. Wotton, 3 Cal. 2d 384 [44 P.2d 350].)

The evidence indicates that the operating arrangements between Shupp and each location owner were the same as those considered by us in Appeal of C. B. Hall, Sr., Cal. St. Bd. of Equal., Dec. 29, 1958, 2 CCH Cal. Tax Cas. Par. 201-197, 3 P-H State & Local Tax Serv. Cal. Par. 58145. Accordingly, our conclusion in Hall that the machine owner and each location owner were engaged in a joint venture in the operation of the machine is applicable here. One-half of the coins deposited in Shupp's machines were thus includible in his gross income.

In the Appeal of Advance Automatic Sales Co., Cal. St. Bd. of Equal., Oct. 9, 1962, 3 CCH Cal. Tax Cas. Par. 201-984, 2 P-H State & Local Tax Serv. Cal. Par. 13288, we held the ownership or possession of a pinball machine to be illegal under Penal Code Sections 330b, 330.1 and 330.5 if the machine was predominantly a game of chance or if cash was paid to players for unplayed free games. We also held bingo pinball machines to be predominantly games of chance.

We conclude that Respondent properly applied Section 17359. In addition to the fact that much of Appellant's equipment was of the multiple-odd bingo pinball type, the record indicates that it was a general practice to make cash payouts for free games to the players of these machines.

Two location owners testified that they had Appellant's pinball machines during the years under review and that they regularly made cash payouts for free games. They received the

amount of these payouts back from the proceeds of the machine before the remainder was split with Shupp. Appellant's former employee testified that while he devoted most of his time to repairing equipment and did little collecting, expenses which included payouts for free games were invariably claimed by the location owner whenever he did make a collection. The Franchise Tax Board's auditor testified that he had interviewed additional persons, not called as witnesses, at two of Shupp's locations who admitted that cash payouts were made to players.

In addition to the bingo pinball equipment, Appellant owned some flipper games, shuffleboards, and late in 1954, music equipment. Since Shupp used the same facilities and employees to make repairs on and to collect from all of his coin operated devices, we conclude that the legal operation of the shuffleboards and other equipment was associated or connected with the illegal pinball operation and that Respondent correctly disallowed all of the expenses of the business.

In making his investigation, Respondent's auditor asked Shuppto estimate the proportion of his reported gross income that-was attributable to bingo pinball games, since his records did not furnish this information. Shupp estimated that in 1951 and 1952, 75 percent of his income came from these games and that in 1953 and 1954, 85 percent came from such equipment. Since there was no record of the amounts claimed by location owners as expenses, these amounts were estimated by the auditor to be 50 percent of the total sums deposited in the bingo pinball machines. These figures were then used to adjust Shupp's reported income in order to reconstruct his gross income.

Respondent's estimate of the expenses claimed by location owners was'based on a figure given by a location owner in the course of the audit. At the hearing in this appeal, one locatior owner estimated the expenses at approximately 25 percent and another at approximately 35 percent. We conclude that Respondent's estimate of expenses should be reduced to 40 percent.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing

therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Peter N. and Adele Shupp against proposed assessments of additional personal income tax in the amounts of $2,082.09 and $3,115.13 assessed against Peter N. Shupp individually for the years 1951 and 1952, respectively; in the amount of $191.36 assessed against Adele Shupp individually for the year 1952; and in the amounts of $6,215.30 and $8,098.56 assessed against Peter N. and Adele Shupp jointly for the years 1953 and 1954, respectively, be modified by recomputing gross income in accordance with the opinion of the Board. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 19th day of December, 1962, by the State Board of Equalization,

Geo. R. Reilly, Chairman

John W. Lynch, Member

Paul R. Leake, Member

Richard Nevins, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary